

# ***The quarter close***

A look at this quarter's  
financial reporting issues

## ***Directors edition***

December 17, 2013

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## What you need to know—Q4—2013

Welcome to the fourth quarter 2013 edition of *The quarter close – Directors edition*. As the calendar year comes to an end, the FASB and IASB are putting the finishing touches on the long-anticipated revenue standard. Private Company Council (PCC) efforts have produced new accounting alternatives for private companies in less than a year. And the EITF capped off 2013 by finalizing four separate consensuses.

What else is cooking this quarter? Read on for the latest developments.

**Front and center.** The FASB and IASB are ready to serve up the new revenue recognition standard after reaching final decisions on several hot button issues.

► [Click here for our Top 5 financial reporting reminders for year-end.](#)

**Accounting hot topics.** Our menu of hot topics for this quarter includes several driven by strategic business decisions that have not-so-obvious accounting consequences. We feature structured payables programs, tax incentives, changes in retiree healthcare plans, and stock repurchases.

**Hot off the press.** In addition to the latest private company financial reporting developments, we highlight an element of the FASB's proposal for eliminating development stage entity guidance that may have a broader impact than expected.

**Video perspectives.** Some companies are moving their retirees to healthcare exchanges. Our experts weigh in, giving an overview of options and their accounting implications, and discuss the steps other companies are taking. Also, if your company provides services for a fixed fee, tune in to find out whether the FASB's proposed guidance for insurance contracts could affect your accounting in an unanticipated way.

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## Front and center

### Revenue recognition standard — all that's left is the icing

In October, the FASB and IASB (the boards) wrapped-up their revenue recognition deliberations by ending the debate on three key issues: variable consideration, licenses, and collectibility. The boards now expect to issue a final standard in early 2014.

#### *Constraint on variable consideration and sales- or usage-based royalties*

Accounting for variable consideration—revenue that is not fixed, such as volume-based fees or performance bonuses—has generated significant discussion throughout the boards' deliberations. The boards agreed that revenue should include an estimate of variable consideration, as long as management has relevant experience with similar performance obligations and it is "probable"<sup>1</sup> that there will not be a significant reversal of revenue in the future. This means revenue recognized should include any minimum amount expected to be received (and subsequent changes to that amount), even if the entire amount cannot be estimated.

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<sup>1</sup> U.S. GAAP and IFRS define "probable" differently ("likely" to occur and "more likely than not," respectively). For purposes of variable consideration, the IASB decided its guidance would require a "highly probable" threshold that there will not be a significant reversal of revenue in the future. This difference in wording is intended to result in consistent interpretation between U.S. GAAP and IFRS. However, the IASB did not choose to make a similar change for collectibility.

► *Click here to watch our experts discuss how the upcoming revenue model could affect your company.*

### *Accounting for licenses — point in time or over time?*

The boards decided on a model that distinguishes between two types of licenses—one that provides a *right to use* IP and one that provides *access* to IP. A key consideration is whether the nature of the underlying IP is “static” or “dynamic.” A license of static IP is considered a right to use IP and results in revenue recognition when control has transferred to the licensee and the license period has begun. A license of dynamic IP provides the customer with access to the IP as it exists at any point in time, resulting in revenue recognition over time.

### *Collectibility*

After some back and forth, the boards decided to include a collectibility threshold in the final standard. This means a company will only recognize revenue when it is “probable” the company will collect the consideration it is entitled to for goods or services. Companies will determine whether a contract meets this threshold by assessing both the customer’s ability and intent to pay as amounts become due. This decision could result in different conclusions under U.S. GAAP as compared to IFRS since “probable” does not have the same definition under both frameworks.<sup>1</sup>

### *What’s next?*

The boards expect to release the final standard in the first quarter of 2014. For more information, see [Dataline 2013-23](#), *Revenue from contracts with customers: Boards wrap up redeliberations — A look at the recent decisions*.

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## *Accounting hot topics*

### *This quarter’s hot topics:*

- Structured payables programs
- Accounting for tax incentives
- Changes to retiree healthcare plans
- Share repurchases

### **Structured payables programs are on the rise**

Banks are increasingly offering structured payables programs as one way to provide companies with much desired liquidity. But participation in this type of program could affect how the liability is presented in the financial statements.

### *What is a structured payables program?*

Under these programs, the bank pays vendors on behalf of the company in advance of a payable’s due date, providing the vendor with money sooner than it would have otherwise received it. The

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<sup>1</sup> See footnote on page 1.

company typically pays the bank back at a date later than the original payable was due, or they share in a portion of the discount that was realized by the bank paying the vendor early. Either way, the company enhances its liquidity.

### *An assessment of facts and circumstances*

Assessing the accounting for these programs is not always black and white. In some cases, the terms of the payable may have changed such that classifying the liability as a trade payable is no longer appropriate. It may ultimately be more akin to a short-term financing. This determination affects both the balance sheet and statement of cash flows presentation. In addition, if the liability is classified as short-term financing, there could be an impact on income statement classification as well.

In speeches dating back almost a decade, the SEC staff emphasized that all of the relevant facts and circumstances of structured payables arrangements should be analyzed to determine whether the economic substance of the company's liability has changed.

When analyzing a structured payables program, it is important to obtain a thorough understanding of the terms of the company's obligations to all parties and determine whether it is reflective of a typical trade payable in that jurisdiction. This analysis should include considering the roles and responsibilities of each party, changes to the initial payment terms, and changes in the legal nature of the payable.

## **Government tax incentives — the accounting implications**

Governments often use tax incentives to entice foreign investment and economic development. These tax incentives can come in several different forms, including tax holidays, reduced tax rates, exemptions, and special deductions. Some of these benefits are available to any company operating in the jurisdiction, while others require specific application or qualification requirements.

### *Is the incentive in the scope of income tax accounting or other guidance?*

Companies need to analyze the tax incentives to determine whether they are in the scope of income tax accounting (affecting income tax expense/benefit) or other guidance (affecting pre-tax income). Even though the incentive may be claimed on an income tax return, it may not be within the scope of income tax accounting. For example, if the benefit of the tax credit is not dependent on having taxable income, the incentive generally would not be in the scope of income tax accounting and other guidance would apply.

### *The recipe for determining the right accounting*

Companies need to analyze the specific aspects of the incentive regime to determine the appropriate accounting. Here are some common examples of incentives and the accounting implications.

| Incentive                                       | Example(s)   | Accounting implications  |
|---|--|--|
| Government grant                                | Tax credit granted for expenses incurred or investments made, and the company is entitled to the credit irrespective of whether it has taxable income          | The benefit is not within the scope of income tax accounting. It is generally recognized in pre-tax income over the period for which the grant was intended to compensate.   |
| Tax holiday                                     | Reduced tax rate for a period of time; may be specific to a company or generally available to any company within a class of companies <sup>2</sup>             | A deferred tax asset should not be recorded for the future anticipated benefits. However, the applicable rate used to measure deferred taxes for temporary differences should consider when those differences are expected to reverse. |
| Tax credit carryforward or additional tax basis | Tax credit granted at the outset of a program for expenses or investments a company will incur in the future   | If the entire tax benefit is not taken in the current period, the remaining benefit would be recorded as a deferred tax asset and would be subject to an assessment of realizability.  |
| Special deduction                               | Special deductions available for certain healthcare companies, small life insurance companies, statutory depletion or qualified domestic production activities | Special deductions reduce income tax expense in the year in which the benefit is reported in the company's tax return.   |

*No need for companies to start from scratch*

Our [Tax accounting insight](#), *Tax holidays and other incentives: determining the right accounting model*, discusses the relevant accounting guidance and highlights some of the factors to consider in determining which guidance applies.

## Changing retiree healthcare plans? The projected obligation should use fresh assumptions

With healthcare costs continuing to rise and increased buzz about healthcare exchanges created by the Affordable Care Act, companies have been examining the healthcare benefits they offer retirees. Recent trends have included reducing or eliminating benefits entirely. Other companies have moved retirees to both private and public healthcare exchanges. These changes may have significant accounting implications.

### *Healthcare exchanges — still a benefit plan*

Companies moving retirees to exchanges may no longer administer a retiree healthcare plan directly, but instead provide their retirees with the cash to buy their insurance on the exchange. Such changes may reduce the company's costs while providing more options and flexibility to retirees. Even though the company no longer directly

► Click here to watch our experts discuss the accounting considerations of moving retirees to healthcare exchanges.

<sup>2</sup> Companies receiving tax holidays in foreign jurisdictions must (1) disclose the aggregate dollar and per share effects of the tax holiday and (2) briefly describe the factual circumstances including the date on which the special tax status will terminate.

administers the plan, providing participants subsidies to purchase insurance on healthcare exchanges is still a healthcare benefit plan. However, the projected benefit obligation recorded in the financial statements would need to incorporate changes in the forecasted retiree healthcare costs.

### *Reducing or eliminating benefits*

Changes in benefits could create a negative plan amendment, a curtailment or both. Companies that choose to reduce or eliminate healthcare benefits that have already been earned through past service create a negative plan amendment. These amendments reduce the obligation and create a prior service credit that is recognized in the income statement in future periods. Beyond just affecting retirees, companies should also consider whether the changes could impact current employees that expect to be entitled to benefits when they retire. A change that eliminates post-retirement benefits for a significant number of current employees triggers a curtailment, which could require the company to recognize previously deferred costs or gains.

## **Considering a stock repurchase? Understand the accounting implications in advance**

Share repurchases and tender offers are a continuing trend and come in many different flavors. Companies execute these repurchases for a variety of reasons, including to return capital to shareholders, reduce the number of shares outstanding, or avoid the potential dilution that results from options being exercised. The design of the repurchase could have some unsavory accounting implications, so it's important to consider the financial statement implications before pulling the trigger.

### *Common ingredients in a tender offer*

Tender offers typically state a fixed price at which the company is willing to repurchase shares. In other offers, though, a company may agree to repurchase shares at a price within a specified range, with that price dependent upon the outcome of an auction process. In addition to specifying the price, tender offers also specify the expiration date of the offer and the maximum number of shares the company will repurchase (and sometimes the minimum number). Shareholders then elect whether or not to accept the tender offer.

### *Accounting considerations*

A careful analysis of the terms and conditions of tender offers is necessary to determine whether it is a treasury stock transaction or something more complicated. For example, in some fact patterns the acceptance of a tender offer by shareholders creates a written put option on the company's own stock (accounted for as a mark-to-market liability). Key provisions that could affect the accounting treatment include the period of time over which the offer extends and the legal rights of the shareholder upon acceptance of a tender offer, among others. Companies may need to consult with legal counsel as part of this evaluation.

### *For more information*

For more details on the accounting considerations associated with share repurchases, see our [\*Guide to Accounting for Stock-based Compensation\*](#).



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## *Hot off the press*

### **PCAOB issues revised proposal on disclosing more information about the auditors**

At its December meeting, the PCAOB repropose amendments requiring auditors to disclose the name of the audit partner in the audit report. The revised proposal also requires audit reports to include the locations and extent of participation of other public accounting firms, and people who participated in the audit but are not employed by the audit firm. The names of the other public accounting firms would also need to be disclosed. The disclosure threshold for these participants is five percent or more of total audit hours. This most recent proposal is a follow-up to one issued by the PCAOB in October 2011. Comments are due February 3, 2014.

### **FASB serves up definition of a public business entity**

Although the FASB and PCC have moved forward with developing accounting alternatives for private companies, a key open question was how to define a private company. This quarter, the FASB answered that question by deciding on a final definition of a “public business entity.”

#### *What’s a public business entity?*

Under the final definition, an entity meeting any of five criteria is a public business entity. Since public business entities are not eligible to apply the accounting and reporting alternatives available to nonpublic entities, the FASB’s approval of the public business entity definition creates a de facto definition of a nonpublic entity.

In short, companies that file or furnish financial statements or financial information (voluntarily or as required) with the SEC in any fashion cannot apply the private company alternatives. In addition, companies that file or furnish financial statements to any other regulatory agency, make them publicly available pursuant to a legal, contractual, or regulatory requirement, or that have securities on an over-the-counter market are also prohibited from applying the private company alternatives.

#### *Understanding the definition is important for private and public companies*

While the accounting and reporting alternatives may feel like an early holiday gift for many private companies, companies need to assess the full impact of adoption. For example, a company should consider any strategic plans that could cause it to become a public business entity in the future and trigger a need to retroactively adopt public company standards.

### **FASB approves first private company alternatives**

The FASB endorsed two accounting and reporting alternatives for private companies, marking the first standards to come from the efforts of the PCC.

The first alternative allows private companies to amortize goodwill over a period of ten years, or less in certain circumstances. In addition, companies would apply a simplified goodwill impairment model. The second alternative makes it easier for private companies that are not financial institutions to qualify for hedge accounting for certain interest rate swap arrangements.

While the effective date for these alternatives is fiscal years beginning after December 15, 2014, early adoption will be permitted. Final standards are expected before the end of the year. Public companies should also stay tuned since the FASB has agreed to consider whether the goodwill alternative (or aspects of it) should be available to all companies.

#### *Next up: VIE exemption for common control leasing arrangements*

At its November meeting, the PCC voted to provide private companies an exemption from applying the variable interest entity (VIE) consolidation model to certain common control leasing arrangements. Under the proposed alternative, a private company could elect to be exempt if certain criteria are met.

#### *For more information*

For more information on these accounting alternatives, refer to the November edition of the [\*Private company reporter\*](#).

### **Development stage entity proposal affects...consolidation?**

At first glance, the FASB's latest proposal on development stage entities (DSE) may appear to affect only a narrow group of entities. However, the proposal could have unintended consequences for a broader group of companies.

#### *The linkage between the DSE and consolidation guidance*

The FASB proposal eliminates the concept of DSE from U.S. GAAP in its entirety. In an effort to conform other accounting guidance, the FASB proposed removing a paragraph that has played a key role in determining whether a DSE is a VIE. This proposed change would result in more DSEs being VIEs, which could affect the consolidation conclusion of certain companies.

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## **SEC matters**

### **Quick hits — SEC leadership and rulemaking updates**

In October, Mark Kronforst was named chief accountant of the Division of Corporation Finance succeeding Craig Olinger, the division's acting chief accountant. Kronforst was formerly an associate director for disclosure operations in the division and previously held several positions including the division's deputy chief accountant role.

The SEC voted unanimously to release a proposal for comment: Regulation Crowdfunding, a series of rules under the Jumpstart Our Business Startups (JOBS) Act that will permit companies to offer and sell securities through crowdfunding subject to specific guidelines.

The SEC also voted 3 to 2 in September to release a proposal for comment that would require a public company to calculate and disclose its CEO compensation as a multiple of the median employee pay. The proposed rule was mandated under the Dodd-Frank Act.

### **SEC hints at COSO expectations**

The SEC offered another hint that it expects companies to transition to the newly updated COSO framework (released in May) for internal control reporting requirements.

► *Click here to watch our experts discuss the updated COSO framework.*



At a September meeting of the Center for Audit Quality's SEC Regulations Committee, the SEC staff indicated that issuers that continue to use the 1992 COSO framework are more likely to receive questions from the staff about whether they are satisfying the SEC's requirement for a suitable, recognized framework. The likelihood of such questions is expected to increase after the COSO-established transition date of December 15, 2014.

For more details on the framework and two new companion documents, see [Dataline 2013-09](#), *COSO issues the updated Internal Control-Integrated Framework and related illustrative documents*.

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## On the horizon

► [Click here to learn how the FASB's insurance proposal may affect non-insurers.](#)

As 2013 comes to a close, expect to see the AICPA issue an update to its 2001 guide on acquired in-process research and development (IPR&D). Acquired IPR&D can represent significant portion of the acquisition price in business combinations. The guide aims to promote comparability among reporting entities around what constitutes IPR&D assets, and the methodologies and assumptions used to value such assets, along with related disclosures.

### **EITF reaches four final consensuses and takes a significant step on pushdown accounting**

The EITF had a full plate at its November meeting, addressing six topics and bringing four of them to closure. The Task Force reached final consensuses on topics related to service concession arrangements, consolidation of collateralized financing entities, classification of collateralized residential mortgage loans upon foreclosure, and affordable housing tax credits. It also decided to issue a proposal related to a creditor's classification of mortgage loans that are guaranteed by the federal government. Finally, the Task Force reached a tentative conclusion on pushdown accounting that would alter current practice.

*For more information*

For more background on the topics discussed by the EITF, read our [November 2013 EITF observer](#).

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## Corporate governance

### **Directors and investors — finding common ground**

There is considerable alignment between directors and investors on the most pressing issues in the coming year. Topping the list of priorities are strategic planning, risk management, and succession planning. However, in some areas, directors' and investors' views diverge. For example, 85% of investors believe the board should be at least "moderately" focused on the company's risk of compromising customer data, but only 61% of directors say they are engaged in such privacy issues at that level.

The PwC publication *What matters in the boardroom? Depends on whose shoes you're in* examines the views of corporate directors and institutional investors on current corporate governance issues. The report analyzes the results of PwC's *2013 Annual Corporate Directors Survey* and *2013 Investor Survey*. It also includes certain CEO perspectives from PwC's *16<sup>th</sup> Annual Global CEO Survey*.

## **Communicating with shareholders — a new resource**

While management handles investor relations and shareholder communications at most companies, direct dialogue between the board and shareholders may be beneficial.

*Director dialogue with shareholders — what you need to consider* is a new publication from PwC's Center for Board Governance and the law firm Weil Gotshal & Manges LLP. It describes the public company-shareholder communications environment and shares practical insights from directors and investors.

Questions boards should ask when considering communications with shareholders include, among others:

- Which topics are appropriate for director communications?
- Which directors should be involved?
- When should directors get involved in shareholder communications?

The publication also includes a list of “Do’s and Don’ts” for directors regarding dialogue with shareholders, as well as shareholder-to-shareholder advice about communicating with directors.

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